

LAW OFFICE  
PETER C. WILLIAMS  
510 KING STREET, SUITE 416  
ALEXANDRIA, VIRGINIA 22314  
(703) 684-8813

CPJ  
5/6/98

MEMBER, DISTRICT OF COLUMBIA  
AND VIRGINIA BARS

FACSIMILE  
(703) 548-4742

May 2, 1998

Cynthia L. Johnson  
Director  
Cash Management Policy and  
Planning Division  
Financial Management Service  
Department of the Treasury  
Room 420  
401 14th Street, S.W.  
Washington, DC 20227

Re: Notice of Proposed Rulemaking -- 31 CFR Part  
210 -- Federal Government Participation in  
the Automated Clearinghouse

Dear Ms. Johnson:

I have several comments on the proposed rulemaking. While not intended to be comprehensive, I believe they warrant FMS' consideration as it proceeds toward adoption of the NACHA Rules as the principal framework for governing the electronic transfer of its payments (credits and debits) and related payment information.

The proposal to utilize a tried and proven system with which the banking industry is familiar is more than appropriate. Yet, from my prior experience as general counsel to a \$1.2B financial institution with its own data processing unit, unless certain provisions are to be revised, the expected reduction in "conflicting or duplicative requirements" may well prove to be illusory because of separate programming/exception processing and additional training that will be required.

Verification of Identity of Recipient (Sections 210.4(a), 210.8(c))

These provisions in their present form are perhaps the most troublesome. Considered together, they present three significant

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issues -- reallocation of risk, scope of RDFI responsibility and the standard of care. The first would create a conceptual inconsistency. Although FMS wishes to utilize and participate in an existing framework with which the industry is quite familiar, at the same time it wishes to alter a fundamental precept within that framework by shifting the origination warranty long since allocated to the ODFI (see ACH Rule 2.2.1.1) to the RDFI with respect to the authorization of payments. Aside from the fairness issues arising from this proposal, the change would affect and run counter to the basic assumptions embodied in the Rules. The potential for confusion, possible losses and software reprogramming costs arising from implementing such a change could be substantial. Also, even though the Federal Government is by far the largest single user of the ACH system and even though many of its concerns are in fact unique, by making this change is this the sort of precedent the Government wishes to set for other large, i.e., dominant, users of the system in the future.

The scope of what exactly is to be expected of an RDFI in terms of verification of identity must be clarified. If it is clearly limited to verifying the *identity* of a recipient as opposed to confirming, directly or indirectly, the *eligibility* for receipt of benefits or other payment, then there is substantially less of a problem. The separate issue of the additional costs associated with providing for verification of the validity of signatures is not addressed here.

Most troublesome, however, is the standard of care FMS would presume to impose. Concern in this regard arises from language in the commentary (in the third paragraph under the heading "Section 210.4 - Authorizations and Revocation of Authorizations") that speaks of replacing the due diligence standard with "an *absolute* requirement the RDFI or agency accepting the authorization verify the recipient's identity and, *where appropriate*, the recipient's signature." (Emphasis added) If the proposed standard is not of sufficient concern for financial institutions, the language following it certainly is, e.g.,

The Service continues to believe that the authorization process represents an opportunity to reduce fraud . . . [and] the Service believes it is appropriate to hold [the party that accepts the authorization] *strictly liable* for the identity of the recipient.

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(Emphasis added). Nothing appears in proposed Sections 210.4(a) or 210.8(c)(2) that would counter an assertion that an RDFI is subject to a strict liability standard. In fact, the proposed rule is mandatory as to the need to verify the validity of the recipient's signature.

Not only does this requirement exceed FMS' efforts elsewhere in the NPRM to convert the standard of care from "due diligence" to "actual or constructive knowledge" and "commercially reasonable business practices", but the language in the commentary would appear to belie any claims that the Government does not wish to saddle the banking community with additional enforcement duties that are really the responsibility of government. What is different here is that, unlike other instances in which the banking industry has been conscripted to assist in law enforcement, e.g., administering the Bank Secrecy Act and processing CTRs, deposits would be placed at risk. As opposed to increased operating costs associated with this type of responsibility that can be forecast, this risk cannot.

Finally, although FMS has noted the problem of how the validity of signatures might be verified through automated enrollment and other electronic transactions, it needs to deal with the issue now. With the recent amendments to Reg E, the issue will become critical sooner than later. In addressing the issue, an additional concern is the standards that will be applicable to DFIs that wish to verify the validity of signatures digitally.

#### Incorporation of Preemptions into ACH Rules

The phrase "in accordance with this part" or similar language is interspersed throughout both the proposed rule and the commentary, e.g., in Sections 210.4(b)(1), 210.6(c), (d), 210.7(a), 210.8(c)(2), 210.9(a) and 210.11(d). Most of the references simply reflect either a full or partial preemption to the ACH Rules that FMS is proposing; however, its inclusion in 210.8(c) can be a trap for the unwary. This is the provision that would trigger liability, for instance, if signature validity verifications, required under Section 210.4(a), are not secured.

While attorneys and other professionals are paid to notice nuances such as the one contained in Section 210.8(c)(2), back-office staff may not appreciate this subtlety without adequate

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training. Yet, the consequences of missing this particular nuance could have a substantial negative impact on an institution.

### Reversals

Notwithstanding FMS' expressed concern as to whether agencies may be able to effect reversals within the five banking day window established by the ACH Rules, FMS has elected in proposed Section 210.6(g) for agencies to be bound by this time constraint; however, since reversals are addressed in both subsections (e) and (g) of this section, FMS might wish to clarify that the last sentence in proposed subsection (g) applies to both subsections, e.g. ". . . under this section 210.6 . . .".

Subsection (g) also references reversals of entries by agencies (a defined term) and files by the *Federal Government* (not defined). Regardless of the reason for the distinction, a separate question may arise when attempting to pair the source of the original files with that of the reversing file if the source is in fact different.

Subsection (e) raises a substantive issue in that it would impose an amorphous responsibility - and potential loss - on an RDFI should it fail "to follow standard commercial practices in processing the entry[ies]." (The entry[ies] to which this phrase speaks would appear to be the original entries.) Given that the proposal specifically intends to shift a portion of the risk of loss to the RDFIs by introducing a comparative negligence standard in cases where an agency effects a reversal, FMS's acceptance of the time limitations may not be that meaningful. This is especially so in the case of erroneous, as opposed to duplicate, entries. What if the Receiver were correct but the amount "materially" wrong?

Subsection (e) would not apply to reclamations, but would apply to benefit and other payments. If nothing else, the proposal magnifies the importance of financial institutions' compliance with the authorization and prenotification verification requirements of proposed Sections 210.4 and 210.8.

Finally, proposed Section 210.6(g) would require agencies to certify compliance only to FMS. This protects FMS but creates a problem for an RDFI (and other parties involved) as they would have

no right to rely on the certification and thus to indemnification under ACH Rule 2.4.5 because the certification [representation and warranty] does not run to them -- or would they have such right? Because the ACH Rules are based in contract rather than in regulation, attention to contract principles remains that much more important. Perhaps FMS could clarify its intent in this respect.

#### Use of TFM and Green Book

In several places in the commentary, FMS discusses its intent to move a number of "procedural" provisions to either the TFM or the Green Book (see paragraphs 6 and 7 under the heading "Section 210.3 -- Governing Law", third paragraph under the heading "Subpart B - Reclamation of Benefit Payments" and discussion under the heading "Section 210.14 -- Erroneous Death Information"). Aside from whether a requirement moved to the TFM or Green Book is substantive or procedural in nature, what is perhaps more important is the provision of (a) adequate disclosure of the proposed changes and (b) adequate notice of future modifications to these documents. As institutions become increasingly automated, sufficient notice to permit software adaptation and associated training is essential.

From a technical standpoint, it probably makes sense to make these sorts of changes; however, since FMS twice reminds the public in the commentary that it considers the TFM and Green Book to have the same force and effect of the regulation, it would appear prudent for it to disseminate any procedural changes in a timely manner.

#### Incorporation of ACH Rule Changes

I full support NACHA's position that subsequent ACH Rule changes be automatically incorporated into Part 210 with the Federal Government having the right to opt out prior to the effective date of any change. Not only would the ACH Rule amendment process give the Federal Government adequate notice of contemplated changes to the Rules, but to adopt a contrary approach would also soon lead to a "Balkanization" of the Rules rather than further their universality.

I trust the foregoing will be helpful in formulating a final rule. Again, the principal thrust of the proposal, to establish a

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universal framework of rules applicable to both public and private users of the ACH network, is to be commended. The task of achieving maximum universality and protecting the public interest, all at a fair and reasonable cost, is a delicate one. For the most part, this has been accomplished; however, careful consideration of the foregoing concerns may yield a more efficient and effective result.

If you have any questions, please do not hesitate to contact me.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Peter C. Williams".

Peter C. Williams

cc: Natalie H. Diana, Esq.